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Corporations—Public Policy Test in Membership Corporation Charter Applications Overruled

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the affidavits so as to justify defendant's request for summary relief. For this reason and because of the factual issue apparent on the face of the affidavits, the Court reversed the Appellate Division and denied defendant's motion to dismiss.

Bd.

CORPORATIONS

PUBLIC POLICY TEST IN MEMBERSHIP CORPORATION CHARTER APPLICATIONS OVERRULED

Section 10 of the Membership Corporations Law of New York provides that five or more persons may become a membership corporation "for any lawful purpose." In addition, however, the New York courts have required that the purposes of the proposed membership corporation be in accord with community interests and the public policy of the State. In *Association for the Preservation of Freedom of Choice, Inc. v. Shapiro*,[1] the Court of Appeals rejected the public policy and community interest tests previously used by the lower courts in deciding whether to approve applications for incorporation under the Membership Corporations Law.

The Supreme Court refused to approve the Association's certificate on the grounds that its stated purposes of urging people to support freedom in association and to reject governmental encouragement of either discrimination or anti-discrimination were contrary to public policy and injurious to the community, although admittedly not unlawful.[2]

The Appellate Division unanimously dismissed a petition to order the Supreme Court Justice to revoke his two opinions[3] and on appeal this decision was reversed. The Court of Appeals held, first that "the public policy of the State is not violated by purposes which are not unlawful."[4] This holding makes

1. 9 N.Y.2d 376, 214 N.Y.S.2d 388 (1961). Consolidated with the main case was an action by the Association pursuant to Article 78 to compel the Secretary of State to file its unapproved charter application because Section 10 of the Membership Corporation Law was allegedly unconstitutional. The Supreme Court, New York County, dismissed the petition because Section 10 was not unconstitutional. Association for the Preservation of Freedom of Choice v. Simon, 22 Misc. 2d 1016, 201 N.Y.S.2d 135 (Sup. Ct. 1960). The Appellate Division unanimously affirmed. 11 A.D.2d 927, 206 N.Y.S.2d 532 (1st Dep't 1960). The Court of Appeals affirmed without discussion.

2. In 17 Misc. 2d 1012, 187 N.Y.S.2d 706 (Sup. Ct. 1959) at pages 1013 and 707 respectively the Justice said:

> In passing upon an application for the approval of a membership corporation, the duty of the court is not merely to see to it that the requirements of the statute have been met, but also to judicially determine whether the objects and purposes of the proposed corporations are lawful, in accord with public policy and not injurious to the community.

When asked to reconsider he replied in 18 Misc. 2d 534, 188 N.Y.S.2d 885 (Sup. Ct. 1959) at pages 535 and 887 respectively:

> Certainly the sponsors of the proposed membership corporation are completely free to associate for the purposes they spell out in the proposed certificate. . . . But they may not compel the state to grant them, for these purposes, the benefits and privileges of incorporation as a membership corporation.

3. 10 A.D.2d 873, 202 N.Y.S.2d 218 (2d Dep't 1960).

4. 9 N.Y.2d 376, 382, 214 N.Y.S.2d 388, 394 (1961).

it clear that, in the future, the courts cannot hold, consistently with this decision, that although the purposes of the proposed corporation are not unlawful, they violate public policy.

Since the Supreme Court had withheld approval of the Association's charter on the alternative grounds that the purposes either violated public policy or were injurious to the community, or both, the Court of Appeals also held that "injury to the community" was too vague, indefinite and elusive a standard. Because of the application of this standard, the Court expressed doubts as to whether the lower courts had constitutionally applied the provisions of Section 10 and reasoned that if rejections were limited to cases where the purposes were unlawful, those doubts would be resolved.

As far back as 1896 it was held that public policy and public interest must be considered in deciding whether to approve a charter application. Thus in *In re Agudath Hukehiloth* an application was denied approval because its charter indicated that meetings were to be held on Sunday for the transaction of business.[5]

The ridiculous possibilities of the application of these standards should have become apparent with the decision in *Application of Catalonian Nationalist Club of New York*.[6] There, the purpose of the charter was to inform the people of this country about the Catalonian culture. Approval was withheld because there had been too much teaching of and adherence to foreign culture and a division of the people into groups might result.

In *In re Lithuanian Workers' Literature Soc.*[7] it was reasoned that the court should not make itself the "censor of tastes, social or political"[8] but should approve a charter application whenever its purposes and the methods of carrying out these purposes appear lawful. Nevertheless the courts continued to refuse approval of charters on public policy and community interest grounds.

Thus, in *In re Patriotic Citizenship Ass'n Inc.*[9] Judge Froessel, who dissented in the present case, followed the reasoning of the earlier decisions and refused to approve a charter where the purpose of the proposed corporation was to seek an amendment to the New York Constitution to permit one who advocated forceful overthrow of the government to be involuntarily deprived of citizenship. Judge Froessel, who was then a Supreme Court Justice, found it unthinkable that New York should allow anyone to incorporate for the pur-

5. 18 Misc. 717, 42 N.Y. Supp. 985 (Sup. Ct. 1896). However, even before that case the Court of Appeals had referred to considerations of public policy in passing on the legality of charter purposes. In United States Vinegar Co. v. Foehrenbach, 148 N.Y. 58, 42 N.E. 403 (1895) the defendant argued that the plaintiff corporation's purposes were illegal in an attempt to escape liability on his stock subscription contract. The court found that the purposes involved were not illegal nor "inconsistent with public policy, as declared by public law." 148 N.Y. 58, 64, 42 N.E. 403, 403.

6. 112 Misc. 207, 184 N.Y. Supp. 132 (Sup. Ct. 1920).

7. 196 App. Div. 262, 187 N.Y. Supp. 612 (2d Dep't 1921).

8. 196 App. Div. 262, 265, 187 N.Y. Supp. 612, 614 (2d Dep't 1921).

9. 26 Misc. 2d 995, 53 N.Y.S.2d 595 (Sup. Ct. 1945).

pose of advocating a constitutional amendment of this character. Contrary to the reasoning in *In re Lithuanian Workers' Literature Soc.* Judge Froessel apparently based his decision on personal notions of right and wrong.

Other applications have been denied approval for such reasons as: (1) the name not appropriate in view of the purposes;[10] (2) there being too many organizations already in the area;[11] (3) a confusing and misleading name;[12] (4) the purposes so vague that they might include pernicious lobbying activities.[13]

As the preceding cases illustrate, the use of these nebulous standards has led to considerable uncertainty. Thus, it was apparent to the Court of Appeals that a more definitive standard was necessary.

The statute was clear that only lawfulness of purpose was required. If the Court had rejected the lower courts' standards of public policy and community interest and at the same time had substituted a new standard which required more than mere lawfulness of purpose, such action would have been labeled legislation. The Court thus limited its decision to rejection of the previous public policy and community interest standards.

The statute is now open to new interpretation. To compensate for this judicial directive not to use the previous standards which gave the justices broad discretion, the lower courts are now very likely to interpret "lawful" in its broadest sense. It is likely that approval will be withheld if the purpose, although admittedly within the letter of the law, is not within its spirit.

The two dissenting judges held that refusals to approve were desirable in at least some instances where there is only a violation of public policy.

In support of this position they cited Article I, Section 2 of the New York Constitution which in broad terms prohibits discrimination by any person, firm or arm of the State because of race, color, creed or religion.[14] This provision does not create any new civil rights but is merely authority for their creation.[15]

Pointing out that the Legislature had not enacted penal statutes in all those instances permitted by the constitution,[16] it was argued that discrimina-

10. In re Mazzini Cultural Center, Inc., 185 Misc. 1031, 58 N.Y.S.2d 529 (Sup. Ct. 1945).

11. In re Victory Committee of Greenpoint of Patriotic Social & Fraternal Club, Inc., 59 N.Y.S.2d 546 (Sup. Ct. 1945).

12. Application of Stillwell Political Club, Inc., 109 N.Y.S.2d 331 (Sup. Ct. 1951).

13. In the Matter of the Certificate of Incorporation of Council for Small Business, Inc., 155 N.Y.S.2d 530 (Sup. Ct. 1956).

14. N.Y. Const. art. I, § 2:

> No person shall be denied equal protection of the laws of this state or any subdivision thereof. No person shall, because of race, color, creed or religion, be subjected to any discrimination in his civil rights by any other person or by any firm, corporation, or institution or by the state or any agency or subdivision of the state.

15. Kemp v. Rubin, 188 Misc. 310, 69 N.Y.S.2d 680 (Sup. Ct. 1947), aff'd, 273 App. Div. 789, 75 N.Y.S.2d 768, rev'd on other grounds, 298 N.Y. 590, 81 N.E.2d 325 (1948).

16. See the N.Y. Penal Law § 514 (public employment and public accommodations among others); § 515 (class or price discrimination in admission); § 700 (discrimination by firms, corporations, institutions or the State).

tion clearly against public policy but not violating a criminal statute, could occur. Such discrimination would be against public policy but not unlawful. It was reasoned that if discretion were allowed in such cases, there could be little objection.

The majority opinion, however, limits the courts to considerations of lawfulness only in deciding whether to approve charter applications under Section 10 of the Membership Corporations Law. This limitation will prohibit the use of personal standards and lead to consistency, a reform long overdue.

P. D. C.

"CONTINUING WRONG" THEORY ADOPTED IN ACTION FOR INADEQUATE FREIGHT RATES

In *Ripley v. International Railways of Central America,* the minority stockholders of International Railways (hereafter referred to as Irca) brought suit on behalf of the corporation against the United Fruit Company (hereafter described as United).[17] United was in practical control of Irca by virtue of a voting trust created in 1928;[18] consequently it (United) was in a fiduciary relationship to the minority stockholders of Irca. Damages are based on allegedly inadequate freight rates for hauling United's bananas from the interior of Guatemala to the coast.

In 1936, Irca, United and Compania Agricola de Guatemala (hereafter described as Agricola), a subsidiary of United, entered into business arrangements which were controlled by ten contracts each relating to different aspects of the parties' business dealings. One of these contracts, entitled "Main Agreement," was approved by the stockholders of Irca. This agreement contained terms by which Agricola helped Irca finance new equipment and obtain certain other operating benefits. Agricola received notes and Irca stock in exchange. Agricola also agreed to use the main lines of Irca to transport its bananas and supplies, *"under such arrangements as the parties hereto may agree upon from time to time."*

The "Trackage" and "Operation of Trains" agreements were executed at the same time, but they were not submitted to the stockholders of Irca. These agreements "fixed" the total cost to Agricola for shipping a carload of bananas at $60.00; whereas, a similar haul would cost an independent producer $130.00 after 1939.

The referee awarded damages to the plaintiffs for the difference between the rates paid and the fair and reasonable value of the transportation. Recovery was limited to the six year period preceding the commencement of the action.[19] The referee's determinations were affirmed by the Appellate Division.[20] The Court of Appeals, two judges dissenting, affirmed the judgment.

17. 8 N.Y.2d 430, 209 N.Y.S.2d 289 (1960).
18. Ripley v. International Railways of Central America, 276 App. Div. 1006, 95 N.Y.S.2d 871 (1st Dep't 1950).
19. N.Y. Civ. Prac. Act § 48.
20. 8 A.D.2d 310, 188 N.Y.S.2d 62 (1st Dep't 1959).